No. 22693

United States
COURT OF APPEALS
for the Ninth Circuit

UNITED STATES NATIONAL BANK OF OREGON, PORTLAND, OREGON,

Appellant,

v.

ASOCIACION de AZUCAREROS de GUATEMALA 4a. Av. 14-53(1) GUATEMALA CITY, GUATEMALA,

Appellee.

APPELLANT'S REPLY BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE ROBERT C. BELLONI, Judge

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REPLY TO SUPPLEMENTARY STATEMENT OF FACTS

The Association in its Supplementary Statement of Facts attempts not only to supplement the Statement of Facts in the Appellant's brief, but also attempts to supplement the facts as contained in the record. The Association's brief is replete with statements of fact or factual conclusions without citation to or support in the record or transcript. We shall

point out only the more significant of the misstatements.

The Association implies that the Bank was the beneficiary of the Schroder back-to-back letter of credit, and that the Bank simply forwarded the Association's documents to Schroder (Appellee's Br. pp. 2-3). In fact, PSG was the beneficiary of the credit (Ex. 19), and the Bank merely acted on behalf of PSG (R. p. 72, par. 8). The documents forwarded to Schroder included a new commercial invoice drawn up by Greenberg (Tr. p. 89).

The Association's contention that the Bank's cable relating to the reduction of the first draft contained a misrepresentation is discussed in detail in the Argument portion of this brief.

The Association notes that the Bank failed to tell the Association that Schroder had already paid on the back-to-back letter of credit (Appellee's Br. pp. 3-4), thus implying that Greenberg had received full payment on the resale and that the sugar was fully satisfactory to the ultimate buyer. Payment on the Schroder letter of credit, however, was based upon documents, including the invoice drafted by Greenberg. The possibility of a claim against Greenberg by the ultimate buyer because of poor quality existed between August 26 and October 3 (R. pp. 61-62, Tr. p. 208).

The following statement in the Association's brief is without any citation to the record or transcript, nor can any such support be found:

"Greenberg was by then in dire financial straits—as the Bank well knew—and quickly used the Schroder money to pay other debts.

"Thus, by September 27, the proceeds from the sale of the sugar had been dissipated. The Bank was apparently intent on not paying the Association—even though it had received the shipping documents a month earlier—until it was certain it would be paid by Greenberg." (Appellee's Br. p. 5).

The Association states that its complaint alleged that Greenberg was "secondarily" liable for the purchase price of the GARDENIA shipment (Appellee's Br. pp. 6-7). The complaint actually alleged that PSG, Greenberg and the Bank were "jointly and severally" liable (R. p. 5).

The paragraph which takes up almost the entire page nine of the Association's brief, discussing the circumstances under which the release was given, is without a single citation to the record, nor is it supported by the record.

ARGUMENT

I

There was no evidence in the record to support the finding that the Bank's cable of August 26 contained a false representation.

In seeking to sustain the court's finding that the Bank's cable of August 26, 1968 constituted a misrepresentation, the Association makes no contention

that the statement "POLARIZATION BELOW CREDIT REQUIREMENT" referred to anything other than the standard "basis 96° minimum polarization" fixed in the letter of credit itself. Moreover, the Association does not seek to contradict the clear evidence that the GARDENIA sugar polarized below 96°.[1]

In view of the available evidence, and in the absence of argument by the Association, it must be concluded that the Association admits that the credit established a single standard of "96° minimum polarization." If the language of the credit is given its ordinary meaning, then the Association must admit that the GARDENIA sugar failed to meet the standard in the credit and that the cable did not constitute a misrepresentation.

The Association nevertheless seeks to sustain the trial court's finding of misrepresentation upon the theory that an alleged "trade usage" controls both the interpretation of the credit standard and the cable's reference thereto. The Association relies upon the testimony of its manager, John Bellamy, to the effect that within the sugar trade raw sugar is de-

[1] The record clearly establishes that the sugar polarized below 96°. On the date of the cable approximately one-third of the GARDENIA shipment had been tested and the tests disclosed that the sugar was polarizing between 93.3° and 95.7°, well below the 96° minimum fixed by the credit (Ex. 224). Final test results by three separate laboratories on 14 samples varied between 93.25° and 96.3°, with an average polarization of 95.176358° (Ex. 223, erroneously cited as Ex. "23" on page 31 of Appellant's opening brief). Only one of the samples tested at or above the "96° minimum polarization" fixed by the credit.

fined as sugar polarizing between 94° and 98° (Appellee's Br. pp. 12-14). Regulations established within the trade provide a system of premiums and penalties for sugar which polarizes above or below a 96° standard. In substance, the trade usage asserted by Mr. Bellamy is only a definition of raw sugar and a system of trade price adjustments which accommodate quality variations above or below the 96° base. Ninety-six degrees polarization remains the standard or "bench mark." If sugar fails to polarize at 96°, it does not meet the standard and is therefore subject to compensating price penalties. In this context, cable advice that sugar polarized below the credit requirement is perfectly consistent with the industry standard of 96° and in the case of the GARDENIA sugar was at all times a perfectly accurate statement.

The Association, however, attempts to give the asserted usage a wider application and argues that it properly understood the statement "POLARIZATION BELOW CREDIT REQUIREMENT [basis 96° minimum polarization]" to mean that the sugar polarized below 94°. The Association then reasons that, within the context of this particular usage of the term "96° polarization," the Bank's cable constituted a misrepresentation. Even if the Association is correctly interpreting the trade usage, neither the Association's conclusion nor the court's finding can be sustained on the basis of such a usage.

While a particular trade usage such as that alleged here may be used to define the terms of an

agreement, or to give meaning to other manifestations of the parties' intentions, it is basic to the operation of such usage that the party to be bound know or have reason to know of the existence and nature of the usage. *Montgomery* v. *United States National Bank of Portland*, 220 Or. 553, 349 P.2d 464 (1960); *Barnard & Bunker* v. *Houser*, 68 Or. 240, 137 Pac. 227 (1913).[2]

The proper circumstances for application of special usage to determine the meaning of language are well summarized in Section 247 of the Restatement of Contracts:

> "A usage is operative upon parties to a transaction where and only where
>
> (a) they manifest to each other an assent that the usage shall be operative, or
>
> (b) either party intends the effect of his words or other acts to be governed by the usage, and the other party knows or has reason to know this intention, or
>
> (c) the usage exists in such transactions and each party knows of the usage or it is generally known by persons under similar circumstances, unless either party knows or has reason to know that the other party has an intention inconsistent with the usage."

---

[2] The Association's brief cites Fair Pavilions, Inc. v. First National City Bank, 24 App. Div. 2d 109, 264 N.Y.S.2d 255 (1965), rev'd, 19 N.Y.2d 512, 281 N.Y.S.2d 23 (1967), in support of its contention that a letter of credit should be interpreted according to "trade usage." (Appellee's Br. p. 16). That case did not deal with the application of trade usage to letters of credit.

Comment b to Section 247 states:

> "Accordingly one who seeks . . . to define language . . . must show either that the other party is actually aware of the usage, or that the existence of the usage in the business to which the transaction relates is so notorious that a person of ordinary prudence in the exercise of reasonable care would be aware of it."

The burden was on the Association to establish that the Bank knew or had reason to know of the usage of the sugar trade and that the Association was interpreting the Bank's communications in accordance with that usage. Restatement, Contracts § 247, comment c (1932). Here the Association only offered the testimony of its own manager that within the sugar trade and its trade association 96° polarization meant a sliding scale from 94° to 98°, within which area variations in price are admittedly required. On trial, the Association did not contend nor did it offer evidence that the Bank dealt within the sugar trade or knew or agreed to the trade's peculiar interpretation of the term "96° polarization." Nor is there any evidence that the Bank knew or should have known that the Association would construe its cable advice of August 26 in terms of that peculiar usage.

Moreover, the trade meaning asserted by the Association is based upon only a part of the language of the credit requirement and totally disregards the credit's use of the additional word "minimum." Mr. Bellamy admitted that he excluded the word "minimum" found in the credit requirement and read its standard as "ba-

sis 96° polarization" rather than "basis 96° minimum polarization" (Tr. p. 218).

Even if it is assumed that the term 96° polarization has a trade meaning equivalent to 94° to 98° polarization, any confusion as to the standard fixed by the credit and the nature of the representation contained in the cable should have been obviated by the addition of the word "minimum" to the letter of credit standard. The word "minimum" under any accepted usage would establish a floor or base figure rather than the sliding scale asserted by Mr. Bellamy. The word "minimum" is defined in Webster's Third New International Dictionary as "the smallest or least—the least quantity assignable, admissible or possible in a given case." See also *Board of Education of Rockford* v. *Page*, 33 Ill.2d 372, 211 N.E.2d 361 (1965). Transposing this definition into the letter of credit, it is apparent that a standard of "[not less than] 96° polarization" is established. It is, moreover, apparent on the record that when effect is given to all terms of the credit standard, sugar polarizing at 95.176358° did not meet the 96° minimum standard imposed.

Since the trade usage asserted does not consider the actual terms of the standard fixed by the credit and since there was no evidence to establish Bank knowledge of the asserted usage, the cable is properly construed in accordance with the ordinary meaning of its language and so construed cannot be considered a misrepresentation.

Oregon law requires that a false representation

must be established by clear, satisfactory and convincing evidence, and cannot be presumed or assumed on the basis of doubtful evidence. *Miller* v. *Protrka*, 193 Or. 585, 238 P.2d 753 (1951). The Association has failed to meet this requirement.

II

The Bank's obligation to the Association was discharged or satisfied by virtue of the mutual release entered into by the Association, PSG and Greenberg.

A. A letter of credit involves a suretyship relation.

In its brief the Association managed to reach the conclusion that a letter of credit transaction does not involve a suretyship relation by redefining the term "suretyship" to accomplish its own purposes. The Association's brief states: "A surety, on the other hand, is not liable unless and until his principal is liable and defaults" (Appellee's Br. p. 20). Therefore, the Association concludes, a letter of credit transaction cannot involve a suretyship relation because: "The buyer's refusal to pay, or the seller's inability to collect from the buyer, is not a condition precedent to the issuer's liability" (Appellee's Br. 18-19).

The Association apparently confuses "suretyship" and "guaranty." A "guaranty," as the term is normally used, is a particular class of suretyship relation in which the surety is only liable upon the principal's default. Not all suretyship transactions, however, fall into the guaranty category.

In *Atterbury* v. *Carpenter*, 321 F.2d 921 (9th

Cir. 1963), cited in the Association's brief, the Court noted:

> "The Oregon courts defer to both the Restatement [of Security] and Arant [on Suretyship] for the most accurate descriptions of these relationships." 321 F.2d at 924.

The Restatement of Security plainly states that a surety's liability need not be contingent upon nonperformance of the principal:

> "When the statement is made that the principal should perform, or that the principal has the principal or primary duty and the surety an accessorial or a secondary duty, it does not mean that the creditor's assertion of his right against the surety must be postponed until some action is taken against the principal. So far as the creditor is concerned, the surety may be the primary obligor. Where principal and surety are bound jointly, from the standpoint of the creditor there is no secondary liability." Restatement, Security § 82, comment f, at 229-30 (1941).

The Restatement notes that "a suretyship obligation conditioned upon the inability of the creditor to collect from the principal is usually called a guaranty of collection." Restatement, Security § 82, comment g, at 231 (1941). Not all sureties, however, fall into that category:

> "The surety may be bound to the creditor on the maturity of the principal's obligation, on the principal's default, or only after certain attempts have been made to obtain payment from the principal." *Ibid.*

Arant on Suretyship notes the most significant distinction between a guarantor and other sureties:

> "The outstanding and perhaps only important respect in which the guarantor's undertaking differs from that of the surety is that it is expressly conditioned on the principal's nonperformance of duty." Arant, Suretyship 20 (1931).

The Association makes much of the fact that an issuing bank may not go beyond the documents and that the performance of the sales contract by seller is not a condition precedent to the issuing bank's liability on the letter of credit. Although this may prevent the issuing bank from being a guarantor, the bank is still a surety in the broad sense. The parties have merely agreed that any defense the buyer may have as to the seller's performance, not appearing on the face of the documents, will be a defense personal to the buyer and available only as between the buyer and the seller. See Restatement, Security § 108, comment d, at 285 (1941). The significant factor is that the seller is entitled to but one performance—if either the buyer or the issuing bank makes payment of the purchase price, the seller cannot collect from the other. It necessarily follows that if the seller releases the buyer in return for a quid pro quo, without reserving his rights against the issuing bank, the bank is discharged.

The Association contends that the suretyship rules with respect to release of the principal are not applicable here because the buyer had stipulated that the Bank could recover against him any amount the Bank

should be required to pay under the letter of credit. Yet, the surety's right of reimbursement from the principal is an essential feature of the suretyship relation. Absent the right of reimbursement, there is no suretyship relation.

In the present case, PSG and Greenberg had no choice but to stipulate to reimburse the Bank. The Bank's right to reimbursement was established in the contract between it and PSG (Ex. 21).

It is this right of reimbursement which gives rise to the rule that a release of the principal will release the surety absent an express reservation of rights against the surety. To hold otherwise would make the release meaningless because the creditor could proceed against the surety, who would then look to the principal. The courts will not imply such an intent unless it is expressly stated in the document of release. Moreover, to the extent which the principal has given consideration for the release, the creditor will have been paid twice and the principal's estate correspondingly reduced to the prejudice of the surety.

The Association also contends that to apply the law of suretyship would somehow impair the utility of documentary commercial letters of credit. It is difficult to understand, however, in what way the utility of letters of credit is impaired by requiring the seller, when releasing the buyer from any obligation on the sale, to expressly state any intended reservation of right against the issuing bank. This requirement is imposed not only within the suretyship relation, but

also upon any party dealing with persons who are jointly or jointly and severally liable to him, even if the liability is based upon contract. Restatement, Contracts § 120(2) (1933).

Likewise, there is no justifiable reason to fear that the seller in dealing with the buyer would discharge the issuing bank through modification of the sales contract. In the letter of credit the issuing bank consents to any change in the underlying sales contract which does not directly affect the requirements of the letter of credit. See Restatement, Security § 128, comment c, at 341 (1941). Moreover, the bank issuing a letter of credit is a compensated surety, and under the law of suretyship would not be discharged unless the modification materially increased its risk. Restatement, Security § 128(b) (1941).

B. The Bank being a surety, the Association's release of PSG and Greenberg, without reservation of rights against the Bank, discharged the Bank.

The Association asserts that if a release of the principal is given with the acquiescence or consent, express or implied, of the surety, the surety is not discharged (Appellee's Br. pp. 25-26). The Association then contends that the Bank was "fully apprised" of the proposed "arrangement" and "tacitly acquiesced" in it (Appellee's Br. pp. 26-27).

The Association is mistaken both as to the law and the facts. The court in *Trinity Universal Ins. Co.*

v. *Gould*, 258 F.2d 883 (10th Cir. 1958), cited in the Association's brief, stated:

> "While the surety may waive the breach, mere knowledge of the breaching alterations does not amount to requisite consent, nor does knowledgeable silence give consent." 258 F.2d at 886.

To be charged with waiver, the court noted, the surety must knowingly engage in a course of action intended to deceive or mislead.

The opinion in *Pacific Nat. Agr. Credit Corp.* v. *Hagerman*, 39 N.M. 549, 51 P.2d 857, 860-61 (1935), collects many of the authorities holding that mere silence or passive conduct with knowledge of breach does not constitute acquiescence or consent by the surety. The annotation in 101 A.L.R. 1310 (1936) summarizes:

> "The rule that a surety or indorser who merely remains silent on learning of facts which are grounds for his discharge from liability may thereafter assert his claim for release by reason of such facts appears to be established by the majority of the cases upon that point." 101 A.L.R. at 1311.

The Association's brief is also factually in error when it suggests that "the Bank's counsel was fully apprised of the proposed arrangement" (Appellee's Br. pp. 26-27). The Association's affidavit in opposition to the Bank's post-trial motion merely stated that the Bank's counsel was present when, during the course of the trial, "the court was advised that a settlement of the *remaining* issues between the Associa-

tion and Greenberg had been made" (R. p. 129) (Emphasis added). The "remaining issues" were the Association's other claims against PSG and Greenberg and the counterclaims. PSG had already admitted liability on the GARDENIA shipment; at the time of the Association's motion for summary judgment on the GARDENIA shipment, PSG suggested that the court enter an interlocutory summary adjudication of such liability, which could later be applied against PSG's counterclaims (R. p. 55).

Therefore, the Bank at most had knowledge that some settlement might be made of the other claims between the Association and PSG. Certainly there is nothing in the record to suggest that the Bank knew that the Association was planning to enter into a mutual release involving the GARDENIA shipment, with or without a reservation of rights against the Bank (R. p. 125).

The Association contends that a surety who has taken security as indemnity against a possible loss from his undertaking is not released by the creditor's release of the principal. Although the early cases so held on the theory that the indemnified surety occupied the position of principal, this theory was strongly criticized in Arant, Suretyship 186-87 (1931). The Restatement of Security, published in 1941, also rejected the earlier theory and established the rule that a release of the principal discharges the surety from his personal obligation, although the surety must turn over to the creditor any collateral which he is holding.

Restatement, Security § 122, comment c, at 323 (1941).

Simpson on Suretyship endorses the Restatement rule:

> "The rule more in accord with logic and with the actualities of the situation is the Restatement rule, that the release of the principal discharges the surety from his personal obligation, but leaves him liable to account to the creditor for the security. So a surety who has returned the security to the principal *after knowledge that the principal has been released* would be liable to the creditor not on the debt but for the value of the collateral at the time of its return." Simpson, Suretyship 306-07 (1950). (Emphasis added.)

Thus, the surety need account to the creditor only for the collateral on hand at the time the surety acquires knowledge that the principal has been released. As already noted, the Oregon courts follow the Restatement and Arant. *Atterbury* v. *Carpenter*, 321 F.2d 921, 922 (9th Cir. 1963).

The security relied upon by the Association is the general lien on proceeds of the sugar given to the Bank by PSG in the agreement for the issuance of the letter of credit (Ex. 21). The Bank received the proceeds on the Schroder credit on behalf of PSG around August 26, 1966, and deposited the funds to PSG's account (Tr. pp. 107-08). It is doubtful whether the Bank could have withheld the entire amount of the proceeds at that time, since the Association had not yet asserted the claims involved in this litigation.

Little, if any, of the proceeds remained in PSG's account at the time the release was executed. The Bank, however, is willing to turn over to the Association any security it was holding at the time it discovered the release, if the Court so decrees.

C. The mutual release constituted an agreed satisfaction of the purchase price in mitigation of the Bank's liability on the letter of credit.

The Association admits that it cannot recover twice on the GARDENIA shipment (Appellee's Br. p. 33). Obviously, the buyer's liability on the contract of sale would be reduced by any amount the issuing bank paid the seller under the letter of credit. Likewise, an issuing bank's liability to the seller for failure to honor drafts drawn on the letter of credit would be reduced or mitigated to the extent the buyer pays the seller on the purchase price of the sugar.

This common sense rule is codified in ORS 75.1150 (1), quoted on pages 23 and 24 of Appellant's open-brief, which provides that anything the seller realizes upon the disposition of the goods reduces the seller's damage from the failure to honor the drafts. Therefore, if the buyer elects to keep the goods and pays the seller for them, the seller has not been damaged.

In the present case, PSG (not the Bank, as implied in Appellee's Br. pp. 31-32) elected to keep the sugar and resell it to a New York buyer. It necessarily follows that the Association's damages were mitigated to the extent that PSG and Greenberg gave the Asso-

ciation consideration for the release of their liability to pay for the sugar.

The Association concludes that it received nothing of value for its release of PSG and Greenberg through a reasoning process based upon the assumption that the court's oral finding against the Bank discharged PSG and Greenberg. The Association stated in its brief:

> "The *Gardenia* claim against the Bank was, of course, tried first. The Court held against the Bank. The Association therefore had a *recovery* from the Bank. It could not recover twice. At this point, then, the Association's claim against Greenberg for the *Gardenia* moneys was *superseded*." (Appellee's Br. 33). (Emphasis added).

The brief also states, "the Association had recovered practically all it claimed on the *Gardenia* transaction . . . ." (Appellee's Br. p. 34).

The Association, of course, cites no authority for the proposition that a verdict or judgment against the Bank would discharge PSG or Greenberg. The law is to the contrary. *Ford* v. *Schall*, 110 Or. 21, 27, 221 Pac. 1052, 222 Pac. 1094 (1924); *Sears* v. *McGrew*, 10 Or. 48 (1881).

The Association also contends that it received no value from the release because PSG and Greenberg were insolvent. Yet PSG and Greenberg had $1,265,-423 in counterclaims against the Association from which they intended to satisfy their liability on the GARDENIA shipment (R. p. 55).

The Association states in its brief that the counterclaims were asserted "apparently only for defensive purposes" and that Greenberg "was also not anxious to pursue his own claims against the Association" (Appellee's Br. pp. 9, 34). These statements are not supported by citations to the record; in fact, there is nothing in the record bearing on the merits of the counterclaims.

Greenberg's financial condition no doubt was a major factor leading to the Association's decision to enter into the mutual release. If the Association went to trial with PSG and Greenberg, the most it could hope to collect would be the $250,135 secured by the letter of credit. On the other hand, if PSG succeeded in its counterclaims, the Association might well end up indebted to PSG and Greenberg for $460,000 over the amount of its claims against PSG and Greenberg. Therefore, the Association, in effect, traded a $250,000 receivable in exchange for a release of a potential $1,265,000 liability. It is difficult to find any lack of value in such an agreement.

Finally, the Association argues that it never intended to give up its right to recover on the GARDENIA shipment. Since the trial court declined to hold a hearing on the motion, there is no evidence in the record as to Greenberg's intent. If, however, the Association actually intended to exclude the GARDENIA transaction from the release, then the "gross negligence" which the Association constantly refers to in its brief existed on the part of the Association itself.

CONCLUSION

We respectfully urge that the judgment be reversed.

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